Daily Comment

Confluence Investment Management

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Posted: May 27, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 0.4% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 0.4%. Chinese markets were lower, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite down 0.3%. US equity index futures are signaling a higher open.

With 478 companies having reported so far, S&P 500 earnings for Q1 are running at $63.90 per share compared to estimates of $60.75, which is up 7.3% from Q1 2024. Of the companies that have reported thus far, 77.4% have exceeded expectations, while 18.8% have fallen short of expectations.

The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below with new items of the day in bold. *Note: The latest BWGR will be available later today.*

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
"Update on the US-China Military Balance of Power" (5/12/25) + podcast	"The Looming Battle for US Monetary Policy" (5/19/25) + podcast	Q2 2025 Report Q2 2025 Rebalance Presentation	Confluence of Ideas Podcast Value Equity Quarterly Update

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Our *Comment* today opens with the positive news that President Trump has postponed his threatened additional tariff hikes on the European Union, and the EU has agreed to accelerate the negotiations for a US-EU trade deal. We next review several other international and US developments with the potential to affect the financial markets today, including a welcome pause in the sell-off of Japanese government bonds and a potentially important change in the asset allocation strategy of major US university endowments.

United States-European Union: President Trump on Sunday finally had an extended phone call with European Commission President von der Leyen, which itself was newsworthy after Trump and his administration had kept the European Union at arm's length and sharply criticized it for months. Perhaps more important, Trump also agreed to push out his deadline to reach a US-EU trade deal and avoid massive new tariffs on the EU. The deadline is now July 9. The events point to a thaw in US-EU relations, giving a boost to US and foreign stocks today.

United States-Russia: After Russia on Sunday launched a huge missile and drone attack against about 30 Ukrainian cities, killing dozens, President Trump blasted President Putin on social media, saying, "I've always had a very good relationship with Vladimir Putin of Russia, but something has happened to him . . . . He has gone absolutely CRAZY! He is needlessly killing a lot of people, and I'm not just talking about soldiers."

- The rare criticism of Putin could be a sign that Trump is finally recognizing the Russian leader's uncompromising aggression and menace he poses to European countries. Reports today indicate Trump is even considering new US sanctions against Russia.
- All the same, even if that's the case, it's not entirely clear how Trump's foreign policy would really change. For example, he could still wash his hands of the Russia-Ukraine war and further cut US support for Kyiv, putting more of the burden on Europe. Alternatively, he could conceivably swing toward more support for Kyiv, potentially helping improve the security situation in Europe.

Japan: After weeks of falling values and rising yields, Japanese government bonds with longer maturities are rallying strongly today, pushing yields lower. The shift came after the finance ministry took the rare step of canvassing primary dealers and other market participants for their views on issuance. The move suggests the ministry may be preparing to scale back supply, which could help put an end to the market's recent volatility. However, issues such as the US-Japan trade war and reduced buying by the Bank of Japan could still be a concern.

Chinese Fiscal Policy: The Chinese government has green-lighted a new 767-kilometer canal to link Jiangxi province, a center for electric-vehicle manufacturing and rare earths production, with the coastal powerhouse of Zhejiang. The canal is part of a $44-billion mega project to provide low-cost freight transport via canal between Guangdong, Jiangxi, and Zhejiang. While it's tempting to think China has already made all the high-return infrastructure investments it needs, the canal project is considered an important step in cutting China's high freight costs.

Chinese Electric Vehicle Industry: EV giant BYD on Monday announced a series of deep, new price cuts, one of which would drop the domestic price of its cheapest model to just $7,770. The move is expected to worsen the on-going price war in China's EV market, so Chinese EV stocks dropped sharply yesterday. The move could also incentivize Chinese manufacturers to boost their export efforts, pressuring foreign EV makers as well.

India: Monsoon rains hit the southernmost state of Kerela on Saturday, arriving eight days earlier than normal and marking the earliest monsoon in 16 years. If sustained, the early rains are expected to boost India's agricultural output, help keep a lid on food prices, increase economic output, and potentially bolster political support for Prime Minister Modi. Also, any increase in Indian crop production could have some negative impact on the value of global agricultural commodities.

Eurozone: The hawkish head of Austria's central bank, Robert Holzmann, said in an interview that he sees "no reason" for the European Central Bank to further cut interest rates in either June or July. Since Holzmann sits on the ECB's policymaking committee, the statement suggests a high level of disagreement among ECB policymakers about how to best shield the eurozone economy from the US-EU trade war.

United Kingdom: In an interview, the chief of the government's Debt Management Office, Jessica Pulay, said her agency is starting to reduce its heavy issuance of longer-dated obligations because of waning demand among institutional investors. Shifting issuance more toward shorter-duration debt would likely help to contain the UK's rising interest costs, but it would also subject the government to more financial volatility and give investors more leverage to demand fiscal discipline.

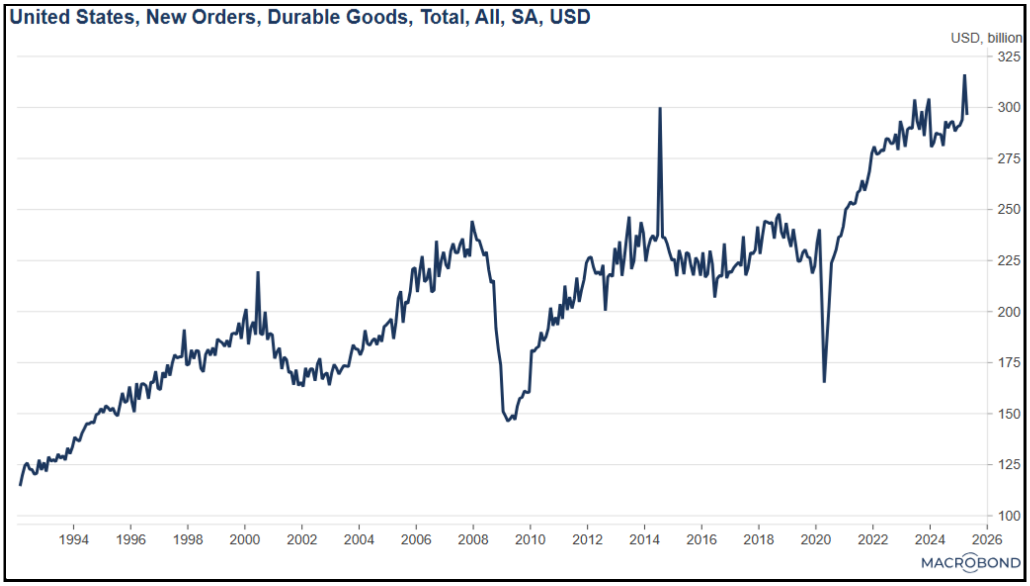
- In any case, Pulay's statement about waning demand for long-dated government debt appears to reflect a growing trend worldwide. For example, it's consistent with the "buyer's strike" hitting Japanese debt, as mentioned earlier in this *Comment*. It's also consistent with the volatility in the US bond market after Moody's recent cut to the US debt rating.
- More broadly, global investors' growing skittishness about long government debt also probably reflects the increased uncertainty and transition risks as the world moves beyond globalization to the new era of greater geopolitical tension, risk, and economic change.

US Financial Markets: Major university endowments are reportedly mulling big changes in their investment strategies in response to the Republican tax and spending bill passed by the House last week. If passed into law, the bill would sharply boost the tax on endowments' investment income. Endowment managers are therefore considering shifting billions of dollars of investments away from assets that generate short-term gains. Instead, they may allocate even more to private equity and debt, which don't realize gains for years into the future.

US Pharmaceutical Industry: The *Wall Street Journal* today carries an article showing how the popular GLP-1 drugs for obesity and diabetes are increasingly being found effective in treating other conditions, including heart disease, kidney disease, liver disease, sleep apnea, arthritis, and even Alzheimer's. With researchers continuing to find new uses for them, GLP-1 drugs could become an even more important part of the pharmaceutical industry's health going forward. However, much will depend on the Trump administration's regulation of the drugs.

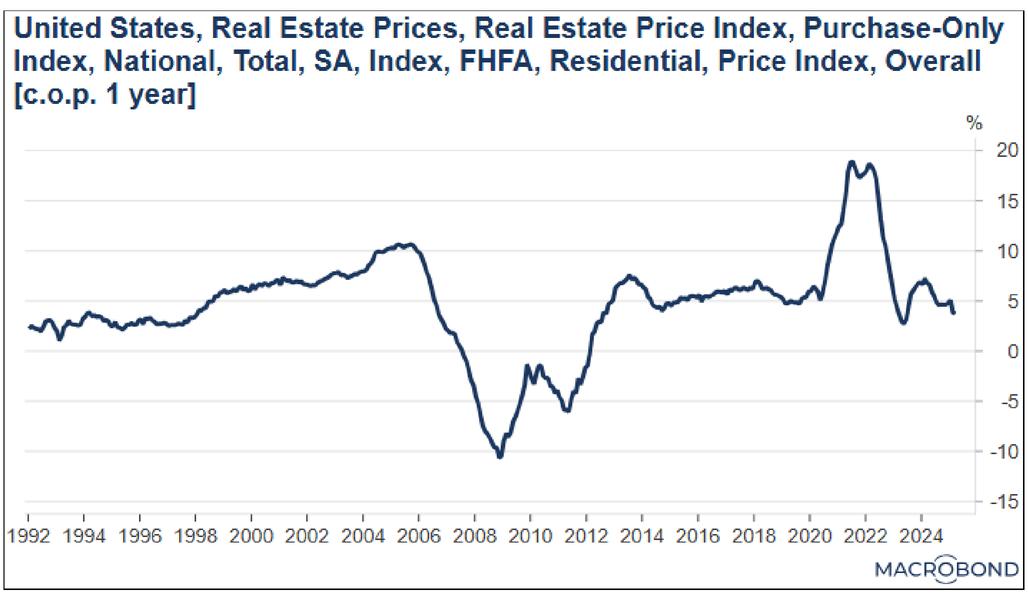
US Economic Releases

US factory orders dropped sharply in April. Last month, ***durable goods orders*** fell by a seasonally adjusted 6.3%, better than the expected decrease of 7.8%. However, March's gain was revised downward from 9.2% to 7.6%. Meanwhile, ***durable goods orders excluding transportation*** rose 0.2%, versus expectations of remaining unchanged and the March revised decrease of 0.2%. Finally, ***nondefense capital goods orders ex-aircraft***, a proxy for business investment, fell 1.3%, significantly missing expectations of a decrease of 0.2% and well below the previous month's revised increase of 0.5%.



Compared with the same month one year earlier, overall durable goods orders in April were up 2.7%, while durable orders ex-transport were up 1.4%. Nondefense capital goods orders ex-aircraft were up just 0.6%.

Home prices slipped slightly in March according to two indexes. Based on an index tracked by the ***Federal Home Financing Agency***, ***national home price index*** fell 0.1% from the prior month, below expectations of a 0.1% rise. Meanwhile, data from ***S&P CoreLogic*** shows that ***top-20 city home prices*** fell 0.2% from the previous month, well below expectations of a 0.3% rise and a February rise of 0.4%.



The chart above shows the annual change in the FHFA House Price Index which rose 3.7% from the previous year.

The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:00	Conf. Board Consumer Confidence	m/m	May	87.1	86.0	***
10:30	Dallas Fed Manufacturing Activity	m/m	May	-23.1	-35.8	**
Federal Reserve						
EST	Speaker or Event	District or Position				
20:00	John Williams Speaks in Moderated Discussion in Tokyo	President of the Federal Reserve Bank of New York				

Foreign Economic News

We monitor numerous global economic indicators on a continuous basis. The most significant international news that was released overnight is outlined below. Not all releases are equally significant, thus we have created a star rating to convey to our readers the importance of the various indicators. The rating column below is a three-star scale of importance, with one star being the least important and three stars being the most important. We note that these ratings do change over time as economic circumstances change. Additionally, for ease of reading, we have also color-coded the market impact section, which indicates the effect on the foreign market. Red indicates a concerning development, yellow indicates an emerging trend that we are following closely for possible complications, and green indicates neutral conditions. We will add a paragraph below if any development merits further explanation.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
Japan	Coincident Index	y/y	Mar F	115.9	116.0		**	Equity and bond neutral
	Leading Economic Index	m/m	Mar F	108.1	107.7		**	Equity and bond neutral
	PPI Services	y/y	Apr	3.1%	3.3%	3.0%	*	Equity and bond neutral
South Korea	Consumer Confidence	m/m	May	101.8	93.8		*	Equity and bond neutral
China	Industrial Profits	y/y	Apr	3.0%	2.6%		*	Equity and bond neutral
EUROPE								
Eurozone	EU27 New Car Registrations	y/y	Apr	1.3%	-0.2%		***	Equity and bond neutral
	Consumer Confidence	m/m	May F	-15.2	-15.2		**	Equity and bond neutral
	Economic Confidence	m/m	May	94.8	93.8	94.1	***	Equity bullish, bond bearish
	Industrial Confidence	m/m	May	-10.3	-11.0	-10.5	*	Equity and bond neutral
	Services Confidence	m/m	May	1.5	1.6	1.0	*	Equity bullish, bond bearish
Germany	GfK Consumer Confidence	m/m	Jun	-19.9	-20.8	-20.0	**	Equity and bond neutral
France	CPI	y/y	May P	0.7%	0.8%	0.9%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	May P	0.6%	0.8%	0.9%	**	Equity and bond neutral
Switzerland	Domestic Sight Deposits CHF	w/w	23-May	435.7b	434.8b		*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	23-May	443.4b	443.2b		*	Equity and bond neutral
	Real Exports	m/m	Apr	-3.3%	5.4%		*	Equity and bond neutral
	Real Imports	m/m	Apr	-10.0%	5.0%		*	Equity and bond neutral
AMERICAS								
Canada	Retail Sales	m/m	Mar	0.8%	-0.4%	0.7%	**	Equity and bond neutral
Canada	Retail Sales Ex-Autos	m/m	Mar	-0.7%	0.6%	-0.1%	**	Equity bearish, bond bullish
Mexico	Current Account Balance	q/q	1Q	-$7613m	$12813m	-$16235m	*	Equity and bond neutral
Brazil	Current Account Balance	m/m	Apr	-$1347m	-$2644m	-$1900m	**	Equity and bond neutral
	Foreign Direct Investment	m/m	Apr	$5491m	$5990m	$4900m	**	Equity and bond neutral
	IBGE Inflation IPCA-15	m/m	May	5.40%	5.49%	5.49%	***	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow daily. Again, the color coding is similar to the foreign news description above. We will add a paragraph below if a certain move merits further explanation.

Fixed Income	Today	Prior	Change	Trend
3-mo T-bill yield (bps)	423	424	-1	Up
U.S. Sibor/OIS spread (bps)	433	433	0	Up
U.S. Libor/OIS spread (bps)	433	433	0	Flat
10-yr T-note (%)	4.47	4.51	-0.04	Down
Euribor/OIS spread (bps)	204	204	0	Down
Currencies	**Direction**			
Dollar	Up			Down
Euro	Down			Up
Yen	Up			Up
Pound	Down			Up
Franc	Down			Up

Commodity Markets

The commodity section below shows some of the commodity prices and their change from the prior trading day, with commentary on the cause of the change highlighted in the last column.

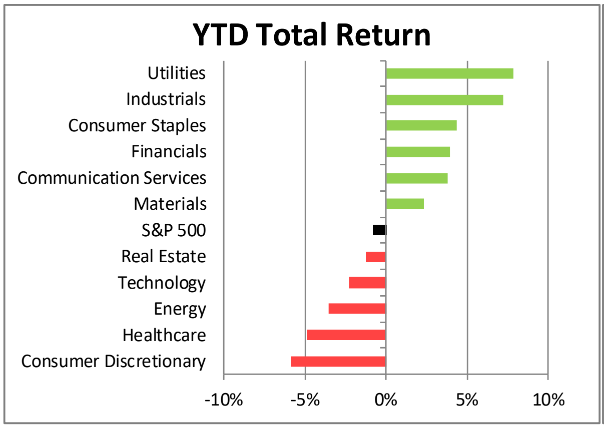
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$64.57	$64.74	-0.26%	
WTI	$61.32	$61.53	-0.34%	
Natural Gas	$3.27	$3.33	-2.04%	
Crack Spread	$25.96	$25.76	0.78%	
12-mo strip crack	$22.13	$22.02	0.51%	
Ethanol rack	$1.91	$1.91	0.00%	
Metals				
Gold	$3,292.21	$3,343.84	-1.54%	
Silver	$32.92	$33.49	-1.69%	
Copper contract	$476.40	$483.65	-1.50%	
Grains				
Corn contract	$457.50	$459.50	-0.44%	
Wheat contract	$533.25	$542.50	-1.71%	
Soybeans contract	$1,063.50	$1,060.25	0.31%	
Shipping				
Baltic Dry Freight	1,340	1,341	-1	

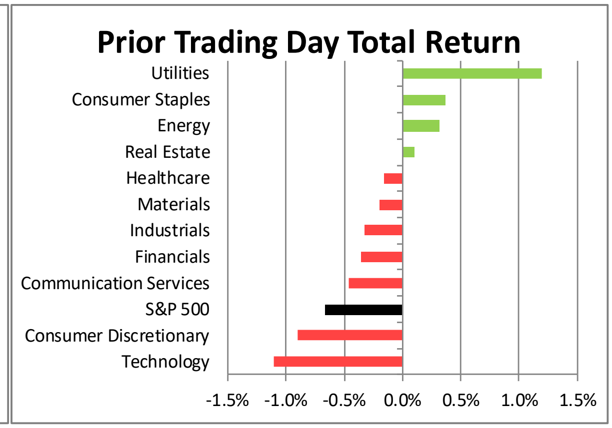
Weather

The 6-to-10 and 8-to-14-day forecasts currently call for warmer-than-normal temperatures, which are expected to shift from the Pacific and Rocky Mountain regions toward the Midwest and East Coast later in the forecast period. Meanwhile, the Southwest is likely to see cooler conditions. For precipitation, wetter-than-normal weather is anticipated across the western half of the US, while drier conditions are forecast for the Midwest and Mid-Atlantic regions.

Data Section

US Equity Markets – (as of 5/23/2025 close)

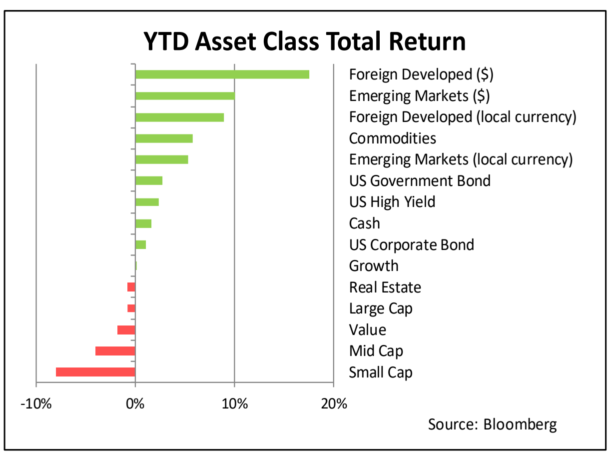




(Source: Bloomberg)

These S&P 500 and sector return charts are designed to provide the reader with an easy overview of the year-to-date and prior trading day total return. Sectors are ranked by total return; green indicating positive and red indicating negative return, along with the overall S&P 500 in black. These charts represent the new sectors following the 2018 sector reconfiguration.

Asset Class Performance – (as of 5/23/2025 close)

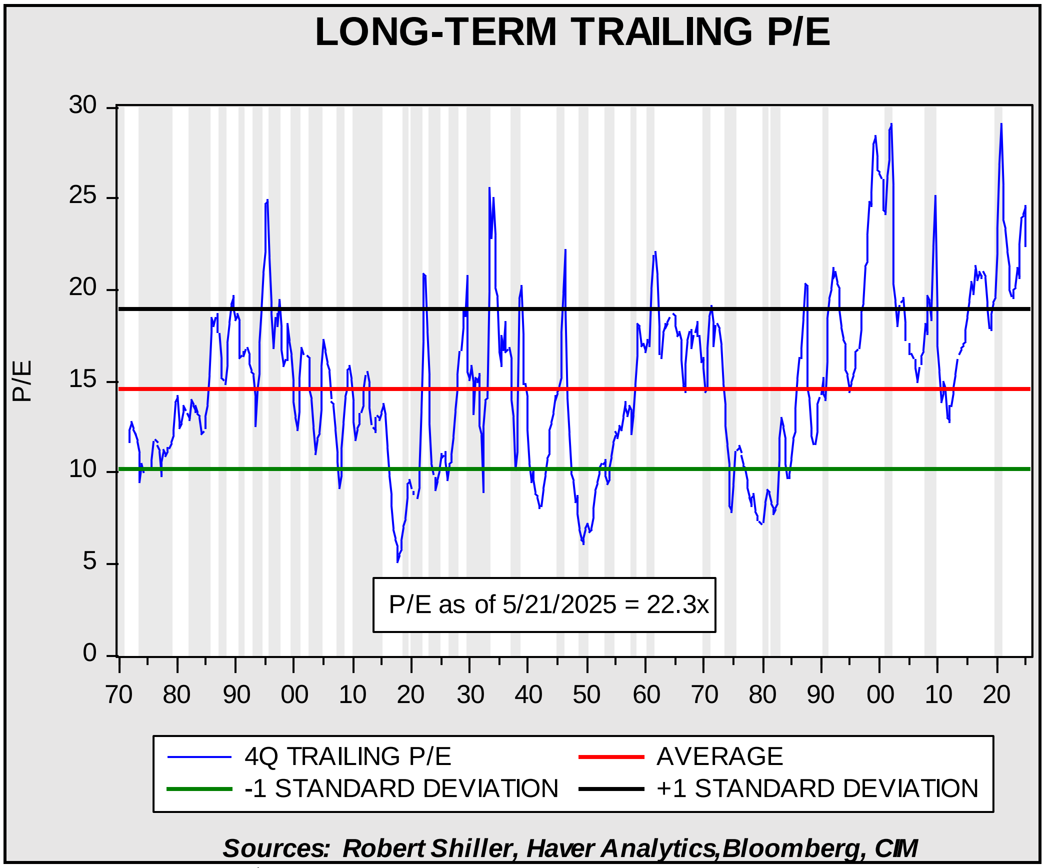


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

Asset classes are defined as follows: Large Cap (S&P 500 Index), Mid Cap (S&P 400 Index), Small Cap (Russell 2000 Index), Foreign Developed (MSCI EAFE (USD and local currency) Index), Real Estate (FTSE NAREIT Index), Emerging Markets (MSCI Emerging Markets (USD and local currency) Index), Cash (iShares Short Treasury Bond ETF), US Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), US Government Bond (iShares 7-10 Year Treasury Bond ETF), US High Yield (iShares iBoxx $ High Yield Corporate Bond ETF), Commodities (Bloomberg total return Commodity Index), Value (S&P 500 Value), Growth (S&P 500 Growth).

P/E Update

May 22, 2025



Based on our methodology,[1] the current P/E is 22.3x, up 0.3 from our last report. The rise in the stock price index outweighed the increase in earnings.

This report was prepared by Confluence Investment Management LLC and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.

[1] This chart offers a running snapshot of the S&P 500 P/E in a long-term historical context. We are using a specific measurement process, similar to *Value Line*, which combines earnings estimates and actual data. We use an adjusted operating earnings number going back to 1870 (we adjust as-reported earnings to operating earnings through a regression process until 1988), and actual operating earnings after 1988. For the current quarter, we use the Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes three actual quarters (Q2, Q3, and Q4) and one estimate (Q1). We take the S&P average for the quarter and divide by the rolling four-quarter sum of earnings to calculate the P/E. This methodology isn't perfect (it will tend to inflate the P/E on a trailing basis and deflate it on a forward basis), but it will also smooth the data and avoid P/E volatility caused by unusual market activity (through the average price process). Why this process? Given the constraints of the long-term data series, this is the best way to create a long-term dataset for P/E ratios.